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Graham Mills
Senior Advisor
Australian Energy Market Commission

SUBMISSION ON THE PROPOSED AMENDMENT TO THE MARKET PRICE CAP, CUMULATIVE PRICE THRESHOLD, AND ADMINISTERED PRICE CAP

Dear Graham

Energy Consumers Australia appreciates the opportunity to provide comments to the Australian Energy Market Commission (AEMC) on its rule change consultation. The Reliability Panel (the Panel) has requested to materially increase the market price settings (Market Price Cap (MPC), Cumulative Price Threshold (CPT) and Administered Price Cap (APC)).

As you know, Energy Consumers Australia is the national voice of residential and small business energy consumers. We thank the AEMC for deciding to undertake an extensive stakeholder consultation process for this important rule change.

Consumers tell us affordability remains their number one priority:[1]

- 55% of household consumers and 44% of small business consumers believe having affordable energy for all Australians is the most important issue to consider when asked to select from a variety of issues facing the sector and consumers; and
- 59% of household consumers and 63% of small business consumers are concerned that energy will become unaffordable for them in the next three years.

The proposed amendment comes at a time when consumers have received news of significant energy bill increases in addition to enduring sustained periods of high inflation and interest rate rises. Considering the significant cost-of-living pressures that consumers will face over the coming years, it is unlikely they will support further price increases unless the need is clearly demonstrated.

In recent months there has also been a rapid evolution of the Australian energy policy landscape. These notable changes include:

- the Federal Government's intervention into the domestic gas market to cap the price of gas at $12/GJ;
- the inclusion of an emissions reduction objective to the National Energy Objectives;
- the Federal Government's announcement of a Capacity Incentive Scheme; and
- additional jurisdictional specific reliability schemes as legislated renewable energy targets.

These policies have significantly changed the dynamics of the energy market, and the context for reform is now different from when the Panel made their recommendation in September 2022.

[1] https://ecss.energyconsumersaustralia.com.au/sentiment-survey-june-2023/

In addition to these changes in context, there are further considerations we believe are important for the AEMC to take into account:

1. The incoming Capacity Incentive Scheme, in conjunction with jurisdictional reliability schemes, will be the most effective investment signal – not prices.
2. The newly announced reliability schemes and government intervention in the fuel markets has lowered the cost outlook for generators from what was adopted in the Panel's modelling.
3. The role of the price settings should be to protect market participants, and ultimately consumers, from high prices. Increasing the price cap will deviate from this role.

These three points are expanded on below.

We strongly support the AEMC undertaking updated analysis of the need to increase market price settings. ECA has provided recommendations below for updating that analysis and we would be more than happy to engage with the AEMC on this analysis throughout the process.

1. The incoming Capacity Incentive Scheme, in conjunction with jurisdictional reliability schemes, will be the most effective investment signal – not prices.

As you are aware, the Federal Government has now announced a *Capacity Incentive Scheme*, with an intention to:

> *provide the national framework needed to drive new renewable dispatchable capacity and ensure reliability in Australia's rapidly changing energy market over the next decade and beyond.*[2]

Jurisdictional governments have also announced their own reliability schemes and ambitious renewable energy targets, the most developed being NSW's Long-term Energy Service Arrangements.[3] Like the Capacity Incentive Scheme, the NSW mechanism also provides revenue certainty for private investment in new renewable energy generation, firming and long-duration energy storage.

The Panel was not able to have regard to the reliability schemes when making its decision. It is our view that these schemes are now the key investment signals for the market, not the price settings. Indeed, there have been significant questions about the ability for price caps to signal investment in the first place. For instance, the ESB has said that:

> *It is fundamentally challenging to achieve a precise investment outcome (enough capacity to meet the reliability standard) through a relatively static and indirect investment incentive (the MPC) in a highly dynamic and uncertain investment environment.*[4]

The ESB's analysis shows that since the start of the National Electricity Market (NEM) in 1999, market participants have delivered nearly 12 GW of new scheduled dispatchable capacity. However only around 900 MW (eight per cent) of that new capacity occurred in the past ten years. Furthermore, of that 900 MW, the majority received some sort of government support (via ARENA, state governments or otherwise).

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[2] https://minister.dcceew.gov.au/bowen/media-releases/capacity-investment-scheme-power-australian-energy-market-transformation
[3] https://www.energyco.nsw.gov.au/industry/long-term-energy-service-agreements
[4] https://www.energy.gov.au/sites/default/files/2022-06/Capacity%20mechanism%20high-level%20design%20consultation%20paper.pdf

Additionally, NEM-wide prices may be ineffective and inefficient signals for investors considering the different needs of each jurisdiction. For instance, only New South Wales and Victoria were forecast to be close to exceeding the reliability standard in the review period. Targeted state-based schemes can more directly signal the capacity needs for each jurisdiction.

2. The newly announced reliability schemes and government intervention in the fuel markets has lowered the cost outlook for generators from what was adopted in the Panel's modelling.

The AEMC should consider incorporating revenue from federal and state reliability schemes into its modelling of new entrant investor costs, in addition to other cost forecasts (which are listed in the Consultation Paper). While it may be difficult to precisely assess the value of this revenue, the AEMC could confer with governments to identify a range of estimates that would be suitable for modelling.

The incorporation of reliability scheme revenue will likely result in lower entrant cost forecasts than those included in the modelling that informed the Panel's final decision. Incorporating this revenue would also ensure that consumers do not 'double pay' for the entrant capacity (i.e., once through the state schemes and again through market prices).

In addition, we recommend the AEMC re-assess the costs of a marginal Open Cycle Gas Turbine power plant, considering the significantly lower fuel cost outlook following the Federal Government's intervention in the gas market. The current outlook for gas costs is below $20/GJ, well below the modelling of $40/GJ.[5]

The value of the gas price cap is determined by including "the key costs of domestic supply, including a reasonable return on capital for gas sourced from developed fields."[6] Costs of domestic supply may increase marginally during the next few years because of increased labour or materials costs but a substantial increase is unlikely.

The Federal Government's gas price intervention also has a significant impact on the required level of the APC. ECA supported the temporary increase of the APC to $600 during the energy crisis last year because we considered it would reduce the likelihood of another suspension of the market given market conditions at the time. However, this intervention has changed the dynamics of the market and may mean the proposed increase from its historical $300 level is no longer needed (or only a lower level of increase is required).

To assess the appropriate APC level for the review period, we recommend the AEMC consider updating the analysis presented in Figure 7.1 of the 2022 Reliability Standards and Settings Review Final Report[7], which shows the proportion of fleet with costs exceeding the APC at various levels. The updated analysis would show how many generators would run at a loss at varying APC levels under an updated fuel cost outlook (i.e., gas prices at $20/GJ or lower).

We also recommend the AEMC consider undertaking an analysis of the impact of increasing the APC compared with maintaining reliance on the compensation scheme. The compensation scheme is imperfect but may be a more efficient outcome in the long-term, as a higher APC would mean that all generators would receive a higher wholesale price (after they have already recovered significant gains). Current arrangements ensure that only generators who run at a loss receive compensation, so

[5] https://www.accc.gov.au/inquiries-and-consultations/gas-inquiry-2017-30/lng-netback-price-series; accessed 19 June 2023.
[6] https://minister.dcceew.gov.au/bowen/media-releases/joint-media-release-gas-price-cap-take-effect
[7] https://www.aemc.gov.au/sites/default/files/2022-09/2022%20RSS%20Review%20Final%20Report%20%281%29.pdf

changing the APC might result in higher than efficient costs overall. In other words, increasing the price cap may not be the most efficient solution.

3. The role of the MPC and CPT is to protect market participants, and ultimately consumers, from high prices.

Considering the views outlined above, ECA considers the main role of price caps moving forward being to protect market participants – and ultimately consumers - from sustained high prices. Increasing the MPC and CPT will expose consumers to risks of longer periods of high prices.

The AER, in its submission to the Panel's 2022 Reliability Standard and Settings Review, expressed concern with the CPT's ability to do so at its current levels:[8]

> *The CPT is intended to act as a risk management mechanism to limit the exposure of market participants to high spot prices over a protracted period of time. However, it is unclear whether the operation of the CPT to date has achieved this intended aim. Participants have been exposed to periods of very high prices without the CPT thresholds being breached. For example, prices over a quarter averaged over $200/MWh in Victoria and South Australia in Q1 2019. Further, as recently as last month, prices averaged in excess of $600/MWh over a week in Queensland, without the CPT threshold being breached. Given this, and that it has been nearly two decades since the design of the CPT has been reviewed in detail, we encourage the Reliability Panel to review whether the current design is fit for purpose in this rapidly evolving market.*

We recommend an analysis similar to what is presented by the AER to show how often prices have reached, or have gotten close to the MPC / CPT. If the AER is correct that market participants have been exposed to periods of high prices, even with the CPT at its current level, the justification for increasing the CPT further would be unclear.

Conclusion

ECA considers that given the developments outlined above, and in light of the three additional considerations we have outlined, there is a need for further consideration and review prior to acting on the recommendations of the Panel.

Thank you for the opportunity to provide our feedback. If you have any questions about our comments in this submission, or require further detail, please contact Ashley Bradshaw at ashley.bradshaw@energyconsumersaustralia.com.au.

Yours sincerely

Brian Spak
Director, Energy System Transition

[8] Australian Energy Regulator – Submission to Reliability Panel 2022 Reliability Standard and Settings Review (2022), see https://www.aemc.gov.au/market-reviews-advice/2022-reliability-standard-and-settings-review